104TH CONGRESS
*1st Session*
HOUSE OF REPRESENTATIVES
REPORT
104–389

# STATE TAXATION OF PENSION INCOME ACT OF 1995

DECEMBER 7, 1995.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. GEKAS, from the Committee on the Judiciary, submitted the following

## REPORT

together with

## DISSENTING VIEWS

[To accompany H.R. 394]

[Including cost estimate of the Congressional Budget Office]

The Committee on the Judiciary, to whom was referred the bill (H.R. 394) to amend title 4 of the United States Code to limit State taxation of certain pension income, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

CONTENTS



29–006

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

**SECTION 1. LIMITATION ON STATE INCOME TAXATION OF CERTAIN PENSION INCOME.**

(a) AMENDMENT.—Chapter 4 of title 4, United States Code, is amended by adding at the end the following:

**"§ 114. Limitation on State income taxation of certain pension income**

"(a) No State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State).

"(b) For purposes of this section—

"(1) The term 'retirement income' means any income from—

"(A) a qualified trust under section 401(a) of the Internal Revenue Code that is exempt under section 501(a) of such Code from taxation;

"(B) a simplified employee pension as defined in section 408(k) of such Code;

"(C) an annuity plan described in section 403(a) of such Code;

"(D) an annuity contract described in section 403(b) of such Code;

"(E) an individual retirement plan described in section 7701(a)(37) of such Code;

"(F) an eligible deferred compensation plan (as defined in section 457 of such Code);

"(G) a governmental plan (as defined in section 414(d) of such Code);

"(H) a trust described in section 501(c)(18) of such Code; or

"(I) any plan, program or arrangement described in section 3121(v)(2)(C) of such Code, if such income is part of a series of substantially equal periodic payments (not less frequently than annually) made for—

"(i) the life or life expectancy of the recipient (or the joint lives or joint life expectancies of the recipient and the designated beneficiary of the recipient), or

"(ii) a period of not less than 10 years.

The periodic payment rule under subparagraph (I) shall not apply to a plan, program, or arrangement which would (but for sections 401(a)(17) and 415 of such Code) be described in subparagraph (A). Such term includes any retired or retainer pay of a member or former member of a uniform service computed under chapter 71 of title 10, United States Code.

"(2) The term 'income tax' has the meaning given such term by section 110(c).

"(3) The term 'State' includes any political subdivision of a State, the District of Columbia, and the possessions of the United States.

"(c)(1) Subsection (a) shall not apply to any retirement income which is received by an individual during the calendar year of the loss of nationality of the individual under chapter 3 of title 3 of the Immigration and Nationality Act for reasons of avoiding taxation by the United States or any State (as determined by the Attorney General), or during any succeeding calendar year.

"(2) Notwithstanding any other provision of law, not later than 30 days after the close of each calendar quarter, the Attorney General shall publish in the Federal Register the name of each individual with respect to whom a loss of nationality described in paragraph (1) occurs during such quarter.

"(d) Nothing in this section shall be construed as having any effect on the application of section 514 of the Employee Retirement Income Security Act of 1974.".

(b) CONFORMING AMENDMENT.—The table of sections for chapter 4 of title 4, United States Code, is amended by adding at the end the following:

"114. Limitation on State income taxation of certain pension income.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts received after December 31, 1995.

## PURPOSE AND SUMMARY

The purpose of H.R. 394 is to prohibit State taxation of certain retirement income of a nonresident of the taxing State. It would protect all income received from pension plans recognized as "qualified" under the Internal Revenue Code. It would also exempt income which is received under deferred compensation plans that are

"non-qualified" retirement plans under the tax code, but which meet additional requirements.

To be exempt from State taxation, distributions from non-qualified plans will have to be made in substantially equal installments, not less frequently than annually, over the lifetime of the beneficiary or at least ten years. In addition, the bill protects from State taxation any "excess benefit" plans that are set up because a qualified plan (1) exceeds the $150,000 in employee compensation that may be considered in qualifying for such a plan, (2) exceeds the present limit on the amount of allowable benefits from a defined benefit plan, or (3) exceeds the present limit on contributions to a defined contribution plan.

## BACKGROUND AND NEED FOR THE LEGISLATION

It is settled Constitutional law that States have the power to tax personal income on the basis of (1) the residence of the taxpayer within the taxing State,[1] or (2) the source of the income originating within that jurisdiction.[2] While a resident may be taxed on all of his or her income, regardless of origin, therefore, a nonresident may be taxed only on income derived from past or present employment within the taxing state.

With respect to the source-based theory of taxation, the United States Supreme Court has declared:

> In our system of government the States have general dominion, and, saving as restricted by particular provisions of the Federal Constitution, complete dominion over all persons, property, and business transactions within their borders; they assume and perform the duty of preserving and protecting all such persons, property and business, and, in consequence, have the power normally pertaining to governments to resort to all reasonable forms of taxation in order to defray the governmental expenses.[3]
>
> [W]e deem it clear, upon principle as well as authority, that just as a State may impose general income taxes upon its own citizens and residents whose persons are subject to its control, it may, as a necessary consequence, levy a duty of like character, and not more onerous in effect, upon incomes accruing to nonresidents from their property or business within the State, or their occupations carried on therein. * * *[4]

States have typically followed the Federal practice of deferring income taxes on pension contributions and related investment earnings until they are distributed to the taxpayer after his or her retirement. Objections arise, however, when at that point the retiree has relocated to another State. One State in particular, California, has aggressively sought to tax annuity payments made to retirees who have moved elsewhere. Kansas, Louisiana and Oregon also have the statutory right to tax all types of nonresident pension

---

[1] *New York ex rel. Cohn* v. *Graves,* 300 U.S. 308 (1937); *Lawrence* v. *State Tax Comm'n,* 286 U.S. 276 (1932).
[2] *Shaffer* v. *Carter,* 252 U.S. 37 (1920).
[3] Id. at 50.
[4] Id. at 52.

income. Colorado and New York allow some taxation over a de minimis amount, and at least nine other States, including Connecticut, Delaware, Illinois, Massachusetts, Michigan, Minnesota, Pennsylvania, Vermont and Wisconsin, can tax only non-qualified or other limited types of deferred compensation. A number of other States may have concluded that it is administratively impossible or simply not cost-effective to attempt to tax nonresident pension income.

According to the Federal of Tax Administrators, an association of the principal tax administration agencies in each of the 50 States, the District of Columbia, and New York City, all States with a broad-based income tax provide a tax credit to residents for income taxes paid to another State on income which is also included in the tax base on the State of residence. This system of reciprocal credits or, in some instances, other reciprocal agreements, generally prevents retirement and other income from being taxed in both the State in which it is earned and in the State of residence.[5]

If the retiree has moved to a State that does not impose an income tax, however, there is no system of income tax credits to offset payments made to another State.[6] Residents of such States who are subject to a pension source tax imposed by another State will clearly pay more in taxes than they would in the absence of source taxation.

The opponents of pension source taxes condemn this practice as ''taxation without representation,'' and cite many examples of nonresident pensioners who have been adversely affected by the frequently unexpected imposition of source taxes on their pensions.[7] They strongly believe that nonresidents should not be taxed if they receive no current benefits from their tax payments.

A response to the ''taxation without representation'' argument was provided by Professor James C. Smith, who observed that:

> [T]his misses the mark because it looks to the wrong point on the time continuum. Instead, the time during which the income was earned is the key, The State provided the nonresident with ample benefits * * * while the income was being earned in the State. The fact that the income is taxed at a time when the individual is no longer receiving benefits from a State does not mean that such benefits were never received.
>
> [D]eferral of recognition is a matter of legislative grace. The State could have taxed the pension rights prior to retirement, when they were earned. Had it done so, thereby recouping a fair share of the costs of government while the taxpayer was still a resident and still employed, no objec-

---

[5] Testimony of Harley T. Duncan, State Taxation of Nonresidents' Pension Income: Hearing Before the Subcommittee on Commercial and Administrative Law of the House Committee on the Judiciary, 104th Congress, 1st Session, June 28, 1995 [hereinafter Subcommittee Hearing], p. 55.

[6] Forty-one States and the District of Columbia levy a broad-based personal income tax. New Hampshire and Tennessee levy an income tax on limited types of interest, dividend and capital gains income. Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming do not levy a personal income tax. Testimony of Harley T. Duncan, Subcommittee Hearing, p. 55, n. 4.

[7] See generally the testimony of William C. Hoffman, Subcommittee Hearing, pp. 38–47.

> tion on the basis of lack of benefit or fairness could conceivably have arisen.[8]

Private sector employers are concerned about the complexities of record-keeping necessitated by source taxation, particularly as more States attempt to tax their absent retirees. In many instances the records do not exist that would enable them to re-create their current and former employees' retirement account histories, many of which involve rollovers from previous employers' plans. More complications arise when the retired nonresident taxpayer has previously worked in several different States, each of which seeks to impose a source tax. Also, there are the problems of complying with the requirement that a State must exclude from its pension tax any investment income accumulated while the taxpayer was a nonresident of the taxing State. The employers also stress the enormous and perhaps unmanageable tax filing burden that widespread source taxation would place upon their retirees. The Subcommittee was told by Randall L. Johnson, representing the Profit Sharing Council of America and other employer groups, that:

> [R]etirees can be taxed on the same income by multiple jurisdictions, and retirees, employers, and plan administrators face insoluble record keeping, allocation, and apportionment problems. Unless States are prohibited from taxing nonresidents on their retirement income, increasing numbers of retirees will be overtaxed, and more and more retirees, employers and plan administrators may be forced to endure an endless and mind-boggling tax-accounting nightmare. A nonresident retiree is in a weak position from which to contest a tax assessment made by a distant State, especially when he is unfamiliar with the State's tax laws and unable to obtain any records that might support his position.[9]

The Committee fully recognizes the rights of States to raise revenues in a manner of their own choosing and that Congress should restrict State taxing authority only when such action is clearly necessary. The Committee concludes, however, that the practice of taxing nonresidents' pension income represents such a case. Despite the legal and conceptual bases for pension source taxes, the burdens imposed on retirees, especially those with relatively low incomes, are all too often simply unreasonable.

Congress has the clear authority under the commerce clause of the Constitution[10] to prohibit State taxation of nonresidents' pension income. The activity that is being regulated under H.R. 394 is the economic relationship between a State and its former resident. The transactions at issue are both within the stream of interstate commerce. Both the person who has retired and the pension payments have crossed State lines.

Under H.R. 394 as introduced, States were prohibited from imposing an income tax on any retirement income of an individual who is not a resident or domiciliary of such State. Retirement income was defined to include any income from a specified list of

---

[8] Testimony of James C. Smith, Subcommittee Hearing, p. 25.
[9] Testimony of Randall L. Johnson, Subcommittee Hearing, p. 60.
[10] U.S. Const. art. I, § 8, cl. 3.

qualified plans as well as non-qualified deferred compensation arrangements and retirement pay received by former members of the armed forces and other specified uniformed services.

At the October 19, 1995 Subcommittee markup of H.R. 394, Mr. Nadler offered an amendment to eliminate all non-qualified plans from the protection of the bill. This amendment was defeated by a vote of 3 to 7. An amendment by Mr. Reed was adopted by voice vote striking the original text of section 114(b)(I) and substituting language allowing favorable treatment for non-qualified plans only if they provide for substantially equal periodic payments, made not less often than annually, over the life of the beneficiary or at least 10 years. In addition, Mr. Reed's amendment would allow favorable treatment of "excess benefit" plans that are set up because the qualified plan in a particular instance (1) exceeds the $150,000 ceiling in compensation that may be considered in qualifying for a plan (26 U.S.C. 401(a)(17)), (2) exceeds the present limits on the amount of allowable benefits from a defined benefit plan or (3) exceeds the present limit on contributions to a defined contribution plan (26 U.S.C. 415). By voice vote the bill was reported favorably to the full Committee in the form of a single amendment in the nature of a substitute incorporating the amendment adopted during the markup.

At the full Committee markup on October 31, 1995, an amendment by Mr. Nadler was adopted by voice vote that would deny the exemption from State taxation to any retirement income which is received by an individual who has left the United States and renounced his citizenship, and is found by the Attorney General to have renounced his citizenship in order to avoid taxation by the United States or any State. By a vote of 12 to 17 an amendment by Mr. Conyers was defeated that would have made the Act inapplicable unless the provisions of Title I of the Unfunded Mandates Reform Act of 1995[11] were complied with. By a vote of 9 to 21 a second amendment by Mr. Conyers was defeated that would place a $100,000 cap on the amount of pension payments that could be received by a nonresident retiree each year without being subject to source taxation. By voice vote, the Committee favorably reported H.R. 394, with a single amendment in the nature of a substitute.

## HEARINGS

On June 28, 1995, the Committee's Subcommittee on Commercial and Administrative Law held a hearing on H.R. 394, H.R. 371, and H.R. 744, three bills regarding state taxation of nonresidents' pension income. Testimony was received from Representatives Barbara F. Vucanovich and Bob Stump; Senator Harry Reid; Professor James C. Smith, University of Georgia School of Law; William C. Hoffman, President, Retirees to Eliminate State Income Source Tax (RESIST); W. Christopher Farrell, Legislative Representative, National Association of Retired Federal Employees (NARFE); Harley T. Duncan, Executive Director, Federation of Tax Administrators; and Randall L. Johnson, Director of Benefits Planning, Motorola, Inc., on behalf of The American Council of Life Insurance, The Association of Private Pension and Welfare Plans, The Committee on

[11] Pub. L. No. 104–4; 109 Stat. 48.

State Taxation, The ERISA Industry Committee, and The Profit Sharing Council of America.

## COMMITTEE CONSIDERATION

On October 19, 1995, the Subcommittee on Commercial and Administrative Law met in open session and ordered reported the bill H.R. 394, as amended, by a voice vote, a quorum being present. On October 31, 1995, the Committee met in open session and ordered reported the bill H.R. 394 with amendment by voice vote, a quorum being present.

## VOTE OF THE COMMITTEE

There were two roll callvotes on amendments offered during full Committee markup:

1. An amendment by Mr. Conyers, to provide that none of the provisions in this legislation take effect unless the Unfunded Mandates Reform Act is complied with. The Conyers amendment was defeated by a roll call vote of 12–17.

| YEAS | NAYS |
|---|---|
| Mr. Conyers | Mr. Hyde |
| Mrs. Schroeder | Mr. Moorehead |
| Mr. Frank | Mr. Gekas |
| Mr. Schumer | Mr. Coble |
| Mr. Boucher | Mr. Smith (TX) |
| Mr. Reed | Mr. Schiff |
| Mr. Nadler | Mr. Gallegly |
| Mr. Scott | Mr. Canady |
| Mr. Watt | Mr. Inglis |
| Mr. Becerra | Mr. Goodlatte |
| Mr. Serrano | Mr. Hoke |
| Ms. Lofgren | Mr. Bono |
| | Mr. Heineman |
| | Mr. Bryant (TN) |
| | Mr. Chabot |
| | Mr. Flanagan |
| | Mr. Barr |

2. An amendment by Mr. Conyers, providing for a $100,000 cap in retirement income. The Conyers amendment was defeated by a roll call vote of 9–21.

| YEAS | NAYS |
|---|---|
| Mr. Conyers | Mr. Hyde |
| Mrs. Schroeder | Mr. Moorehead |
| Mr. Frank | Mr. McCollum |
| Mr. Schumer | Mr. Gekas |
| Mr. Nadler | Mr. Coble |
| Mr. Scott | Mr. Smith (TX) |
| Mr. Watt | Mr. Schiff |
| Mr. Becerra | Mr. Gallegly |
| Mr. Serrano | Mr. Canady |
| | Mr. Inglis |
| | Mr. Goodlatte |
| | Mr. Hoke |
| | Mr. Bono |
| | Mr. Heineman |
| | Mr. Bryant (TN) |
| | Mr. Chabot |
| | Mr. Flanagan |
| | Mr. Barr |
| | Mr. Boucher |
| | Mr. Reed |
| | Ms. Lofgren |

## COMMITTEE OVERSIGHT FINDINGS

In compliance with clause 2(l)(3)(A) of rule XI of the Rules of the House of Representatives, the Committee reports that the findings and recommendations of the Committee, based on oversight activities under clause 2(b)(1) or rule X of the Rules of the House of Representatives are incorporated in the descriptive portions of this report.

## COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT FINDINGS

No findings or recommendations of the Committee on Government Reform and Oversight were received as referred to in clause 2(l)(3)(D) of rule XI of the Rules of the House of Representatives.

## NEW BUDGET AUTHORITY AND TAX EXPENDITURES

Clause 2(l)(3)(B) of House rule XI is inapplicable because this legislation does not provide new budgetary authority or increased expenditures.

## CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

In compliance with clause 2(l)(C)(3) or rule XI of Rules of the House of Representatives, the Committee sets forth, with respect to H.R. 394, the following estimate and comparison prepared by the Director of the Congressional Budget Office under section 403 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
*Washington, DC, December 1, 1995.*

Hon. HENRY J. HYDE,
*Chairman, Committee on the Judiciary,*
*House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed H.R. 394, a bill to amend title 4 of the United States Code to limit state taxation of certain pension income, as ordered reported by the House Committee on the Judiciary on October 31, 1995. We estimate that enacting this bill would have no direct effect on federal spending or revenues. Therefore, pay-as-you-go procedures would not apply. CBO estimates that enacting H.R. 394 would result in a net nationwide cost to state governments, in the form of lost tax revenues, totaling at least $25 million per year.

H.R. 394 would prohibit a state from taxing the retirement income of individuals who are no longer residing in that state. Based on information from the Federation of Tax Administrators and from the departments of revenue in 16 states, CBO estimates that this limitation on states' taxing authority would have two primary effects:

States that tax retirement income of nonresidents would lose revenues. Currently, 16 states tax nonresidents on some portion of the retirement income affected by this bill. These states generate at least $70 million in revenue annually from these sources; all of these revenues would be forgone under the bill. Most of the losses would be concentrated in a few states.

Revenue losses could be higher, however, because of the bill's impact on the taxation of certain types of deferred compensation. Most of the 16 states were not able to isolate this particular income in their databases and, therefore, could not provide a dollar estimate of revenue from this source. Based on figures available from a few small states, CBO has included within the $70 million about $10 million in revenue losses that would stem from not taxing this affected deferred compensation income.

States that offer their residents credit for taxes paid to other states on retirement income would realize an increase in tax revenue. CBO estimates that 39 states and the District of Columbia extend a total of at most $45 million annually in such credit. Of these, the states that currently offer this tax credit and that are popular retirement destinations stand to gain the most.

The extent to which one state's revenue gain would offset another state's revenue loss depends on whether the taxed nonresident currently lives in a state that offers a tax credit. Take, for example, an individual who has worked 20 years for the State of California and retires to New Mexico. New Mexico taxes the retirement income of its residents, but, to prevent double taxation, also offers a tax credit for such taxes paid to other states. Under current law, the retiree would owe California taxes on the pension income and, in return, would be able to deduct that amount from the taxes owed to New Mexico. Under H.R. 394, California would lose its power to tax the nonresident retiree, and the retiree would no longer need to claim that credit. While the individual's total tax liability would thus remain unchanged, New Mexico would realize

an increase in tax revenue equal to the amount of the tax credit it previously allowed.

In contrast, consider a similar California employee who retires to Nevada. Nevada has no personal income tax, and therefore, offers no tax credits. Under current law, the retiree owes no income tax to Nevada but owes California taxes on the pension income. Under H.R. 394, California would be denied this tax revenue, but the Nevada state government would receive no benefit. Rather, California's lost revenue would become a dollar-for-dollar decrease in the retiree's tax liability.

Since most affected retirees live in states that offer credit for these types of taxes, CBO estimates that the bulk of H.R. 394's impact would be to shift revenues among states. We based our estimate of the magnitude of this shift on retiree migration data from several of the most heavily affected states. These data indicated the proportion of residents who retire to states that offer tax credits. In our calculation we assumed that all retirees due a credit for taxes paid to other states currently claim that credit. To the extent that this is not the case, the shift in revenues resulting from the bill would be lower, and the overall net cost to states would be higher.

The net overall cost of the bill to state governments would stem primarily from affected retirees who live in states that do not tax personal income or offer such tax credits. Many of these nontaxing states tend to be popular retirement destinations.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Karen McVey.

Sincerely,

PAUL VAN DE WATER
(For June E. O'Neill, Director).

## INFLATIONARY IMPACT STATEMENT

Pursuant to clause 2(l)(4) of rule XI of the Rules of the House of Representatives, the Committee estimates that H.R. 2064 will have no significant inflationary impact on prices and costs in the national economy.

## SECTION-BY-SECTION ANALYSIS

### SECTION 1(a) OF THE ACT

Section 1(a) of H.R. 394 amends chapter 4 of title 4, United States Code, by adding at the end thereof a new section 114.

### SECTION 114 OF TITLE 4

The new section 114 of title 4 creates a limitation on State income taxation of certain pension income. Section 114(a) establishes a general rule prohibiting any State from imposing an income tax on ''any retirement income'' of an individual who is not a ''resident'' or ''domiciliary'' of the taxing State. The determination of an individual's residence or domicile for the purposes of this restriction would be made in accordance with the laws of the taxing State.

Section 114(b) defines various terms used in subsection (a):

Paragraph (1) defines the term "retirement income" as income from any of the following:

(A) A qualified trust under section 401(a) of the Internal Revenue Code ("the Code") that is exempt from taxation under section 501(a) of the Code. "Qualified" plans are the traditional plans maintained by employers, including self-employed individuals, which provide retirement income to employees. They include both defined benefit and defined contribution plans. They are afforded special tax treatment under the Code in that (1) employer contributions are not taxable to employees until benefits are actually distributed; (2) employer and employee contributions to such plans are deductible within certain limits; and (3) income earned by qualified plans assets is exempt from tax while such assets are held in trust.

A section 401(k) plan is simply one form of a qualified defined contribution plan with certain limits on how much may be contributed annually on a "before tax" basis.

(B) A simplified employee pension ("SEP") as defined in section 408(k) of the Code. These plans are "super Individual Retirement Accounts" in which employees, including self-employed individuals, contribute to IRAs on behalf of their employees. A SEP is a type of plan which falls somewhere between a qualified plan and a regular IRA. Because the majority of a particular employer's employees must be covered under a SEP, increased contributions (as compared to regular IRAs) are allowed. Many smaller employers utilize SEPs because they have lesser record keeping requirements than do qualified plans.

(C) An annuity plan described in section 403(a) of the Code. These plans are the functional equivalent of "qualified plans" (section 401(a) of the Code; see (A) hereinabove), except they are funded by annuity contracts.

(D) An annuity contract described in section 403(b) of the Code. These are tax sheltered annuities which utilize insurance contracts to fund a special type of pension arrangement available to employees of public educational organizations and certain other tax exempt organizations.

(E) An individual retirement plan described in section 7701(a)(37) of the Code. These are Individual Retirement Accounts (IRAs), a personal retirement savings program which allows eligible employees and self-employed individuals to make annual contributions of both deductible and non-deductible payments to a trust or other arrangement. The income on invested accounts is tax-deferred. Distributions, to the extent taxable, are taxed upon receipt.

(F) An eligible deferred compensation plan as defined in section 457 of the Code. These plans are set up by State and local governments and permit employees to contribute the lesser of 25% of compensation or $7,500 to the plan with pre-tax dollars. Amounts are taxed to employees when received.

(G) A governmental plan as defined in section 414(d) of the Code. This is a plan established and maintained for its employees by the government of the United States, a State or a political subdivision thereof, or any agency or instrumentality of any of the foregoing.

(H) A trust described in section 501(c)(18) of the Code. This is a trust created before June 25, 1959, which is part of a pension plan

meeting specified requirements and funded only by contributions of employees.

(I) Any plan, program, or arrangement described in section 3121(v)(2)(C) of the Code, provided such income is part of a series of substantially equal periodic payments made for the life or life expectancy of the recipient (or for the joint lives or joint life expectancies of the recipient and the designated beneficiary of the recipient) or for a period of not less than 10 years. Payments under such an instrument may not occur less frequently than annually.

The periodic payment rule established by subparagraph (I) shall not apply to a plan, program, or arrangement which would, but for sections 401(a)(17) and 415 of the Code, be described in subparagraph A.

The effect of subparagraph (I) would be to exclude from State taxation certain amounts of income paid under non-qualified deferred compensation arrangements, that is, plans which are not recognized as ''qualified'' under the tax code. These are unlimited, flexible arrangements without contribution limits, funding requirements, or limits on payout provisions. The availability and use of such arrangements is limited to a small proportion of the work force. Payments made by employers to non-qualified plans are includable in the employee's income in the year in which made, regardless of whether the employee has a right to distribution. Employers often do not fund non-qualified plans, therefore, until they are ready to make actual distributions to the recipients.

Subparagraph (I) also protects from State taxation ''excess benefit'' plans that are set up because a qualified plan in a particular instance (1) would exceed the $150,000 ceiling in annual employee compensation that employers may take into account in determining contributions made to or benefits paid from a qualified plan (section 401(a)(17)); or (2) would exceed the present limits on the amount of allowable benefits from a defined benefit plan or the present limits on the amount of allowable contributions to a defined contribution plan (section 415). Defined benefit plans give employees a special benefit at retirement, commonly based on a percentage of the employee's compensation and number of years of service to the employer. The employer will annually contribute an amount that is actually required to fund the benefit at retirement. Defined contribution plans specify the amount of contribution that is to be made annually. This exemption applies without regard to whether the periodic payment requirements of subparagraph (I) are met.

Under subparagraph (I) the term ''retirement income'' is also meant to include any retirement or retainer pay of a member or former member of a uniformed service computed under chapter 71 (Computation of Retired Pay) of title 10 (Armed Forces) of the United States Code. ''Uniformed services'' means the armed forces (the Army, Navy, Air Force, Marine Corps and Coast Guard), the commissioned corps of the National Oceanic and Atmospheric Administration, and the commissioned corps of the Public Health Service.

Paragraph (2) defines the term ''income tax'' with reference to section 110(c) of the Internal Revenue Code, that is, any tax levied

on, or with respect to, or measured by net income, gross income or gross receipts.

Paragraph (3) defines "State" to include any political subdivision of a State, the District of Columbia, and the possessions of the United States.

The limitations set forth in section 114(a) shall not apply to retirement income received by an individual during the calendar year of the loss of nationality of that individual under chapter 3 of title 3 of the Immigration and Nationality Act, or any succeeding calendar year, if the loss of citizenship was for the purpose of avoiding taxation by the United States or any State. The reason for the individual's renunciation of citizenship shall be determined by the Attorney General. This exception will allow a State to continue to tax the pension income of an individual who becomes an expatriate and renounces American citizenship simply in order to avoid taxation.

Section 114(c)(2) requires the Attorney General to publish in the Federal Register within 30 days of the close of each calendar quarter the names of persons who have relinquished their citizenship in the preceding quarter under circumstances described in paragraph (1).

Section 114(d) provides that nothing in this section shall be construed as having any effect on the application of section 514 of the Employee Retirement Income Security Act of 1974, which with certain exceptions supersedes State law with regard to employment benefit plans.[12] This would prohibit a State from imposing any additional reporting requirements upon employers with respect to retirement plans.

### SECTION 1(b) OF THE ACT

Section 1(b) of H.R. 394 is a conforming amendment revising the table of sections for chapter 4 of title 4 to reflect the addition of new section 114.

### SECTION 1(c) OF THE ACT

Section 1(c) of H.R. 394 provides that proposed 4 U.S.C. would apply to amounts of retirement income received after December 31, 1995.

## CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (new matter is printed in italic, existing law in which no change is proposed is shown in roman):

## TITLE 4, UNITED STATES CODE

* * * * * * *

[12] 29 U.S.C. 1144; Pub. L. No. 93–406.

## CHAPTER 4—THE STATES



### *§ 114. Limitation on State income taxation of certain pension income*

*(a) No State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State).*

*(b) For purposes of this section—*

*(1) The term "retirement income" means any income from—*

*(A) a qualified trust under section 401(a) of the Internal Revenue Code that is exempt under section 501(a) of such Code from taxation;*

*(B) a simplified employee pension as defined in section 408(k) of such Code;*

*(C) an annuity plan described in section 403(a) of such Code;*

*(D) an annuity contract described in section 403(b) of such Code;*

*(E) an individual retirement plan described in section 7701(a)(37) of such Code;*

*(F) an eligible deferred compensation plan (as defined in section 457 of such Code);*

*(G) a governmental plan (as defined in section 414(d) of such Code);*

*(H) a trust described in section 501(c)(18) of such Code; or*

*(I) any plan, program or arrangement described in section 3121(v)(2)(C) of such Code, if such income is part of a series of substantially equal periodic payments (not less frequently than annually) made for—*

*(i) the life or life expectancy of the recipient (or the joint lives or joint life expectancies of the recipient and the designated beneficiary of the recipient), or*

*(ii) a period of not less than 10 years.*

*The periodic payment rule under subparagraph (I) shall not apply to a plan, program, or arrangement which would (but for sections 401(a)(17) and 415 of such Code) be described in subparagraph (A). Such term includes any retired or retainer pay of a member or former member of a uniform service computed under chapter 71 of title 10, United States Code.*

*(2) The term "income tax" has the meaning given such term by section 110(c).*

*(3) The term "State" includes any political subdivision of a State, the District of Columbia, and the possessions of the United States.*

*(c)(1) Subsection (a) shall not apply to any retirement income which is received by an individual during the calendar year of the loss of nationality of the individual under chapter 3 of title 3 of the*

*Immigration and Nationality Act for reasons of avoiding taxation by the United States or any State (as determined by the Attorney General), or during any succeeding calendar year.*

*(2) Notwithstanding any other provision of law, not later than 30 days after the close of each calendar quarter, the Attorney General shall publish in the Federal Register the name of each individual with respect to whom a loss of nationality described in paragraph (1) occurs during such quarter.*

*(d) Nothing in this section shall be construed as having any effect on the application of section 514 of the Employee Retirement Income Security Act of 1974.*

* * * * * * *

## DISSENTING VIEWS

We oppose H.R. 394 in its present form. Although we are sensitive to the burdens imposed on middle income retirees when a state chooses to tax former residents on their pension income, we favor a far more balanced approach to the problem than is evidenced by H.R. 394.

In particular, we would note that last Congress the Judiciary Committee developed a fair and reasonable bipartisan response to the very difficult problem presented by state taxation of non-resident pensions. That legislation (H.R. 546) would have prevented states from collecting taxes on non-resident pensions in an amount up to $30,000 per year if derived from a "qualified" pension plan. H.R. 546 was approved without any objection by the Judiciary Committee and the full House, before dying in the Senate in the closing days of the 103d Congress.[1] H.R. 546 would have protected the vast majority of retirees from any tax requirements while allowing states to continue collecting taxes from wealthy residents who set up elaborate tax avoidance schemes.

Unfortunately, the bill before us leaves out the most important protections which would have been granted to the states last Congress. Specifically, we would note three flaws in the legislation before us—failure to exclude "non-qualified" pension plans from the coverage of the legislation; failure to limit the tax exemption to a specified dollar amount of pension income; and failure to subject the legislation to the recently adopted "unfunded mandate" law.

*1. Failure to exclude "non-qualified" pension plans*

Unlike H.R. 546, the legislation before us would apply to many "non-qualified" as well as "qualified" pension plans.[2] Non-qualified plans are not recognized as pension plans under federal law, and are not subject to any rules, regulations, guidelines or limitations on their use. They are typically used by a small number of highly compensated executives to defer taxes on large sums of compensation. No case has been made that taxing such non-qualified plans is in any way inequitable or that the states are being overly-aggressive in taxing such distributions.

By including non-qualified plans in the legislation, Congress will be opening broad new loopholes for lucrative compensation arrangements, such as golden parachutes, partnership buy-outs, and large severance packages. The State of Illinois notes that "the in-

[1] H.R. 546, as introduced by Rep. Unsoeld (D–WA) on January 21, 1993, exempted all periodic pension payments from state taxation while providing a one-time exemption of $25,000 for lump sum payments. The bill was revised at Committee pursuant to an amendment offered by Rep. Synar (D–OK) to exempt all payments derived from "qualified" pension plans below $30,000 per year. See H.R. Rep. No. 776, 103d Cong. 2d Sess. (H.R. 546).

[2] Although the legislation was modified at Subcommittee so that beneficiaries of certain non-qualified plans could not avoid state pension tax (e.g., involving certain lump sum distributions or where payments are not made over at least a 10-year basis), H.R. 394 would continue to exempt many non-qualified plans from state taxation.

clusion of non-qualified deferred compensation plans in the bill allows [highly paid individuals] to evade State income taxes by participating in these plans during their earning years and moving to a no-tax State upon retirement."[3] University of Georgia Professor James Smith also testified that virtually all American workers participate in some type of qualified plan and that exempting non-qualified plans creates a significant "potential for tax avoidance by highly compensated individuals who funnel amounts into non-qualified plans in the last years before retirement."[4] At the Subcommittee's hearing, Randall Johnson, Director of Benefits Planning at Motorola, stated that all 76,000 of their employees were in qualified pension plans, and that only 400—or .5% of their employees—were in non-qualified plans.[5]

*2. Failure to limit tax exemption to specified dollar amount*

H.R. 394 also fails to specify any dollar limit on the exemption from state income tax for pension income. Last year the House unanimously agreed on a bill which provided for a $30,000 cap on pension payments in a given year. The California Franchise Board estimates that this would have protected over 90% of retirees.[6]

Yet H.R. 394, the legislation approved by the Committee this Congress fails to include a cap of any kind or any magnitude. The tax exemption under the bill will apply whether one earns $10,000 per year or $3,000,000 per year. It is one thing to protect the vast majority of our citizens from complicated administrative burdens, but it is another to open up massive new loopholes which benefit the wealthy, as H.R. 394 does.

*3. Failure to subject the legislation to the recently adopted "unfunded mandate" rules*

The legislation should also be rejected because it constitutes an unnecessary and unfair unfunded mandate on the states. (In fact, presently, 20 states tax some form of nonresident pension tax—California, Kansas, Louisiana, Oregon, New York, Colorado, Connecticut, Delaware, Illinois, Indiana, Massachusetts, Michigan, Minnesota, New Mexico, Pennsylvania, West Virginia, Wisconsin, Vermont, Iowa, and New Jersey.[7] One of the very first pieces of legislation taken up by the new Congress this session was the "Unfunded Mandates Reform Act of 1995."[8] Many Members spoke with grave concern about the Congress imposing new financial burdens on the States, and the unfunded mandates bill responded by creating a series of procedures and requirements designed to limit adoption of new unfunded mandates on the states.[9]

---

[3] Letter from William T. Lundeen, Chief Counsel, Illinois Department of Revenue to the Honorable Henry J. Hyde, August 25, 1995.

[4] State Taxation of Nonresidents' Pension Income, Hearing before the Subcomm. on Comm. and Admin. Law. Comm. on the Judiciary, on H.R. 371, 394, and 744, Serial No. 11, 104th Cong., 1st Sess. (1995), at 33 [hereinafter, "Subcommittee Hearing"].

[5] Id. at 66.

[6] Letter from Janet Gregor on behalf of California Franchise Tax Board, to House Judiciary Committee Minority Staff, October 27, 1995.

[7] Memorandum from Harley T. Duncan, Executive Director, Federation of Tax Administrators to Subcomm. on Comm. and Admin. Law, October 16, 1995.

[8] Pub. L. No. 104–4 (1995).

[9] Pursuant to the Unfunded Mandates Reform Act, the authorizing committees are specifically required to include information about any unfunded mandates in their legislative reports, the

Continued

By limiting the states' ability to raise revenues, H.R. 394 would constitute such an unfunded mandate.[10] In order to avoid subjecting H.R. 394 to the unfunded mandate requirements, the sponsors of the legislation have opted to expedite consideration so it could take effect before the January 1, 1996 effective date of the unfunded mandate law.[11] However, at full committee the Majority rejected an amendment which would have subjected the legislation to the unfunded mandate provisions.[12] In our view, legislative machinations of this nature only increase voter cynicism about a Congress which appears all too willing to bend the rules when it suits their needs.

## CONCLUSION

We would have preferred to be able to support legislation which responds to the legitimate concerns of middle-income retirees without creating a new loophole for non-qualified persons. Unfortunately, instead of bringing forth the reasonable and balanced legislation approved by the House last year, the Majority has brought forward legislation which unnecessarily impedes the legitimate taxing prerogatives of the States. By denying states the authority to tax high value, non-qualified pensions on citizens who relocate, the legislation will significantly limit the states' ability to raise revenue and will subject their remaining residents to even greater taxes.

JOHN CONYERS, Jr.
PAT SCHROEDER.
HOWARD L. BERMAN.
BOBBY SCOTT.
MELVIN L. WATT.
XAVIER BECERRA.
JOSÉ E. SERRANO.

○

---

CBO is required to estimate the costs of the new requirements, and the mandate itself is subject to a point of order which can only be overcome if a majority of the Members vote to override it.

[10] In addition to applying to requirements that a state spend its own funds to meet a federal goal, the term "unfunded mandate" can be construed to include any requirement that a state forego revenues. For example, under the law, "direct costs" are defined to include amounts by which a state would be prohibited from raising in revenues. See Sec. 421(3)(A)(i).

[11] When asked during the Subcommittee hearing whether the legislation might constitute an unfunded mandate, Subcommittee Chairman Gekas replied: "Yes, I have that in mind, and we will consider that in the pre-markup consideration of this legislation." Subcommittee Hearing, supra note 3, at 34.

[12] An amendment offered by Ranking Member John Conyers, Jr. (D–MI) would have subjected H.R. 394 to the provisions of the unfunded mandate law; but was defeated on a 12–17 party line vote.